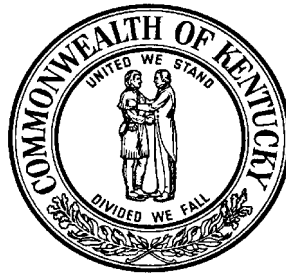


**LETTER FROM THE AUDITOR OF PUBLIC ACCOUNTS
CABINET FOR WORKFORCE DEVELOPMENT**

**In Reference to the Statewide Single Audit
of the Commonwealth of Kentucky**

For the Year Ended June 30, 2002



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EDWARD B. HATCHETT, JR.
AUDITOR OF PUBLIC ACCOUNTS

To the People of Kentucky
Honorable Paul E. Patton, Governor
Willie H. Lile, Secretary
Cabinet for Workforce Development

MANAGEMENT LETTER

This letter presents the results of our audit of the Cabinet for Workforce Development, performed as part of our annual Statewide Single Audit of the Commonwealth of Kentucky.

In planning and performing our audit of the financial statements of the Commonwealth for the year ended June 30, 2002, we considered the Cabinet for Workforce Development's internal control in order to determine our auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide assurance on internal control. We also performed an audit on compliance with requirements applicable to major federal programs, as well as the Schedule of Expenditures of Federal Awards. We noted certain matters involving internal control, compliance, and its operation that we are including in this letter. Some findings are considered to be reportable conditions under standards established by the American Institute of Certified Public Accountants.

Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of internal control and compliance that, in our judgment, could adversely affect the Cabinet for Workforce Development's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions could also adversely affect the Cabinet for Workforce Development's ability to administer a major federal program in accordance with the applicable requirements of laws, regulations, contracts, and grants.

A material weakness is a reportable condition in which the design or operation of one or more internal control components does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the financial statements or federal programs being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of the internal control would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. However, one of the reportable conditions in this letter is a material weakness.



To the People of Kentucky
Honorable Paul E. Patton, Governor
Willie H. Lile, Secretary
Cabinet for Workforce Development

Some findings are Other Matters that we have included in this letter to communicate with management in accordance with Government Auditing Standards.

Included in this letter are the following:

- ◆ Acronym List
- ◆ Schedule of Expenditures of Federal Awards
- ◆ Notes to the Schedule of Expenditures of Federal Awards
- ◆ Findings (Reportable, Material, and Other Matters)
- ◆ Summary Schedule of Prior Year Audit Findings

We have issued our Statewide Single Audit of the Commonwealth of Kentucky that contains Cabinet for Workforce Development's findings, as well as those of other agencies of the Commonwealth. This report can be viewed on our website at www.kyauditor.net.

This letter is intended solely for the information and use of management and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Ed Hatchett", with a stylized flourish at the end.

Edward B. Hatchett, Jr.
Auditor of Public Accounts

LIST OF ABBREVIATIONS/ACRONYMS

AFR	Annual Financial Report
AFP	Apple File Protocol
BDC	Backup Domain Controllers
CFR	Code of Federal Regulations
CFDA	Catalog of Federal Domestic Assistance
CWD	Cabinet for Workforce Development
CIM	Compaq Insight Manager
DES	Department of Employment Services
DHCP	Dynamic Host Confirmation Protocol
DNS	Domain Name Server
DoS	Denial of Service
DTR	Department for Training and ReEmployment
DV	Data Validation
ETA	Employment and Training Administration
FAC	Finance and Administration Cabinet
FSR	Financial Status Reports
FUTA	Federal Unemployment Tax Administration
FYC	Fiscal Year Closing
FY	Fiscal Year
GAAP	Generally Accepted Accounting Principles
GOT	Governor's Office for Technology
HNS	Host Name Server
HTTP	Hypertext Transfer Protocol
HTTPS	Hypertext Transfer Protocol over Secure Socket Layer
ID	Identification
IRS	Internal Revenue Service
JTPA	Job Training Partnership Act
KEIN	Kentucky Employer Identification Number
KEWES	Kentucky Electronic Workplace for Employment Services
KRC	Kentucky Revenue Cabinet
KRS	Kentucky Revised Statutes
LAN	Local Area Network
LSA	Local Security Authority
LWIA	Local Workforce Investment Areas
MARS	Management Administrative Reporting System
MFE	Modernized Front End
NT	New Technology
N/A	Not Applicable
OMB	Office of Management and Budget
PDC	Primary Domain Controller
RACF	Resource Access Control Facility
SNMP	Simple Network Management Protocol
SQL	Structured Query Language
UI	Unemployment Insurance
UIA	Unemployment Insurance - Administration
UPPS	Uniform Payroll and Personnel System
USDOL	United States Department of Labor
WE	Week Ending
WIA	Workforce Investment Act

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2002

CFDA # Program Title	Expenditures		Provided to Subrecipient
	Cash	Noncash	
<u>U.S. Department of Labor</u>			
Direct Program:			
17.002 Labor Force Statistics	\$	996,378	\$
17.203 Labor Certification for Alien Workers		301,735	
Employment Services Cluster:			
17.207 Employment Service		10,206,628	
17.801 Disabled Veterans' Outreach Program		817,796	
17.804 Local Veterans' Employment Representative Program		851,091	
17.225 Unemployment Insurance (Note 2) (Note 3)		570,264,827	18,989
17.245 Trade Adjustment Assistance - Workers		14,423,708	
17.255 Workforce Investment Act (Note 2)(Note 4)		21,609,832	20,051,492
Workforce Investment Act Cluster:			
17.258 WIA Adult Program (Note 2)		13,241,025	12,191,494
17.259 WIA Youth Activities (Note 2)		3,999,874	3,811,628
17.260 WIA Dislocated Workers (Note 2)		11,450,753	10,831,049
17.263 Youth Opportunity Grants		53,510	41,147
17.267 WIA Incentive Grants		73,549	68,150
NA National Occupational Information Coordinating Committee (Note 5)			
Passed Through From Cabinet for Families and Children:			
17.253 Welfare-To-Work - Grants to States and Localities (Note 5)			
<u>U.S. Department of Education</u>			
Direct Programs:			
84.002 Adult Education - State Grant Program		8,894,085	8,410,863
84.048 Vocational Education - Basic Grants to States		8,336,140	6,166,763
84.126 Rehabilitation Services - Vocational Rehabilitation Grants to States (Note 2)		42,904,112	783,549
84.128 Rehabilitation Services - Service Projects		145,271	145,194
84.161 Rehabilitation Services - Client Assistance Program		148,963	
84.169 Independent Living - State Grants		250,070	
84.177 Rehabilitation Services - Independent Living Services for Older Individuals Who are Blind		295,841	

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2002

CFDA # Program Title	Expenditures		Provided to Subrecipient
	Cash	Noncash	
<u>U.S. Department of Education (continued)</u>			
Direct Programs: (continued)			
84.187	Supported Employment Services for Individuals with Severe Disabilities	469,804	
84.224	Assistive Technology	1,389,432	241,828
84.243	Tech - Prep Education	3,056,906	1,439,462
84.265	Rehabilitation Training - State Vocational Rehabilitation Unit In-Service Training	125,924	
84.278	School To Work Opportunities	208,366	184,522
84.346	Occupational and Employment Information State Grants	158,272	5,700
<u>U.S. Department of Health and Human Services</u>			
Passed Through From Cabinet for Families and Children			
93.558	Temporary Assistance for Needy Families (Note 2)	3,288,926	
Passed Through From Cabinet for Health Services			
93.630	Developmental Disabilities Basic Support and Advocacy Grants	118,000	
93.958	Block Grants for Community Mental Health Services	68,333	
TOTAL CABINET FOR WORKFORCE DEVELOPMENT		\$ 718,149,151	\$ 64,391,830

NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2002

Note 1 - Purpose of the Schedule and Significant Accounting Policies

Basis of Presentation - OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, requires a Schedule of Expenditures of Federal Awards showing each federal financial assistance program as identified in the *Catalog of Federal Domestic Assistance*. The accompanying schedule includes all federal grant activity for the Commonwealth, except those programs administered by state universities, and is presented primarily on the basis of cash disbursements as modified by the application of Kentucky Revised Statute (KRS) 45.229. Consequently, certain expenditures are recorded in the accounts only when cash is disbursed. The Commonwealth elected to exclude state universities from the statewide single audit, except as part of the audit of the basic financial statements.

KRS 45.229 provides that the Finance and Administration Cabinet may, “for a period of thirty (30) days after the close of any fiscal year, draw warrants against the available balances of appropriations made for that fiscal year, for the payment of expenditures incurred during that year or in fulfillment of contracts properly made during the year, but for no other purpose.” However, there is an exception to the application of KRS 45.229 in that regular payroll expenses incurred during the last pay period of the fiscal year are charged to the next year.

The basic financial statements of the Commonwealth are presented on the modified accrual basis of accounting for the governmental fund financial statements and the accrual basis of accounting for the government-wide, proprietary fund, and fiduciary fund financial statements. Therefore, the schedule may not be directly traceable to the basic financial statements in all cases.

Clusters of programs are indicated in the schedule by light gray shading.

Inter-Agency Activity - Certain transactions relating to federal financial assistance may appear in the records of more than one (1) state agency. To avoid the overstatement of federal expenditures, the following policies were adopted for the presentation of the schedule:

- (a) Federal moneys may be received by a state agency and passed through to another state agency where the moneys are expended. Except for pass-throughs to state universities as discussed below, this inter-agency transfer activity is reported by the agency expending the moneys.

State agencies that pass federal funds to state universities report those amounts as expenditures.

- (b) Federal moneys received by a state agency and used to purchase goods or services from another state agency are reported in the schedule as an expenditure by the purchasing agency only.

NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2002

Note 2 - Type A Programs

Type A programs for the Commonwealth mean any program for which total expenditures of federal awards exceeded \$17 million for FY 02. CWD had the following programs that met the Type A program definition for FY 02, some of which were administered by more than one (1) state agency. Certain component units and agencies audited by certified public accounting firms had lower dollar thresholds. The Commonwealth identified clusters among the Type A programs by gray shading. These Type A programs and clusters were:

CFDA #	Program Title	Expenditures
17.225	Unemployment Insurance	\$ 570,264,827
17.255	Workforce Investment Act	21,609,832
Workforce Investment Act Cluster:		
17.258	WIA Adult Program	13,241,025
17.259	WIA Youth Activities	3,999,874
17.260	WIA Dislocated Workers	11,450,753
84.126	Rehabilitation Services – Vocational Rehabilitation Grants to States	42,904,112
93.558	Temporary Assistance for Needy Families	3,288,926
Total Type A Programs		<u>\$ 666,759,349</u>

Note 3 - Unemployment Insurance (CFDA #17.225)

The Commonwealth paid out \$543,666,531 in benefits in FY 02. The amounts shown on the accompanying schedule reflect both the amount expended for benefits from the Trust Fund and an additional \$26,598,296 of federal funds expended for administration of the program, resulting in a combined total of \$570,264,827 in federal expenditures.

Note 4 - Workforce Investment Act (CFDA #17.255)

The Workforce Investment Act program (CFDA #17.255) includes expenditures from the Employment and Training Assistance-Dislocated Workers (CFDA #17.246) in the amount of \$165,139 and the Job Training Partnership Act (CFDA #17.250) in the amount of \$16,364,028. When combined with the federal expenditures for CFDA #17.255 of \$5,080,665, the total is \$21,609,832. Since these programs have become part of CFDA #17.255, all expenditures are reported in the schedule under CFDA #17.255.

NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2002

Note 5 - Zero Expenditure Programs

These programs had no expenditures related to the respective state organization during FY 02. The zero expenditure programs included programs with no activity during the year, such as old programs not officially closed out or new programs issued late in the fiscal year. They also included programs with activity other than expenditures.

FINANCIAL STATEMENT FINDINGS***Reportable Conditions Relating to Internal Controls and/or
Reportable Instances of Noncompliance*****FINDING 02-CWD-1: The Division Of Unemployment Insurance Is Not Reviewing
Accounts And Declaring Them Uncollectible**

During testing of delinquent employer account write-offs, we found that the Division of Unemployment Insurance (UI) did not perform any write-offs for FY 02. According to the Unemployment Insurance Tax Branch Manager, due to staff shortages, UI was unable to process any write-offs of delinquent accounts for tax collections for both FY 01 and 02. In response to the FY 01 finding, management indicated that Kentucky Electronic Workplace for Employment Services (KEWES) would implement a process to identify all accounts that are deemed uncollectible and, with proper authorization, automatically make the required change to the accounts to indicate the uncollectible status. During FY 02 testing, it was noted that KEWES was not currently performing this function.

When accounts receivable are not evaluated and written off in a timely manner, the receivables balance tends to be overstated.

Proper accounting procedures dictate receivables be evaluated periodically to determine the likelihood of collection and an amount that is likely to not be collected be written off. KRS 341.300 (4) states:

An action for the recovery of contributions, interest or penalties under this section shall be barred and any lien therefore shall be cancelled and extinguished unless collected or suit for collection has been filed within five (5) years from the due date of such contributions, except in the case of the filing of a false or fraudulent report the contributions due shall not be barred and may at any time be collected by the methods set out in this chapter, including action in a court of competent jurisdiction.

Recommendation

UI should:

- Establish a procedure to estimate a reasonable allowance for uncollectible accounts;
- Age accounts so that accounts over five (5) years and not in litigation are written off in a timely manner; and
- Implement procedures to ensure write-offs of uncollectibles are properly authorized.

FINANCIAL STATEMENT FINDINGS***Reportable Conditions Relating to Internal Controls and/or
Reportable Instances of Noncompliance*****FINDING 02-CWD-1: The Division Of Unemployment Insurance Is Not Reviewing
Accounts And Declaring Them Uncollectible (Continued)**

Management's Response and Corrective Action Plan

DES [Department of Employment Services] does acknowledge that reviews of accounts needing to be declared uncollectible were not done in fiscal year 6/30/2002. We are involved in several processes that will allow us to accomplish this objective during fiscal year 6/30/2003.

Programming by GOT has been completed to declare uncollectible accounts that are more than five years old. DES is in process of declaring which accounts are uncollectible. This should be completed by February 28, 2003.

As a result of legislative action allowing our agency funding for the purpose of establishing an electronic workplace, we have spent a great deal of time and effort on our KEWES project. A new design for declaring accounts uncollectible should be implemented prior to the end of fiscal year 6/30/2003. This process will daily identify those accounts where the delinquency is over five years old without a suit having been filed. These accounts will then be forwarded to the workbasket of a manager for the approval process. Once approval is made by a manager, the KEWES system will proceed with all necessary actions to move the account from collectible to uncollectible.

FINANCIAL STATEMENT FINDINGS***Reportable Conditions Relating to Internal Controls and/or
Reportable Instances of Noncompliance*****FINDING 02-CWD-3: The Cabinet For Workforce Development Should Strengthen Controls Over Estimation Of Accounts Payable**

During the auditors' test of reasonableness of the estimated accounts payable, we noted a material difference between amounts reported on the AFR-70 closing package form and the audited balance at June 30, 2002.

An accounting estimate that is unreasonable could cause the financial statements to be materially understated or overstated.

According to the *Codification of Statements on Auditing Standards* Section AU 342.13, "Review subsequent events or transactions. Events or transactions sometimes occur subsequent to the date of the balance sheet, but prior to the completion of fieldwork, that are important in identifying and evaluating the reasonableness of accounting estimates or key factors or assumptions used in the preparation of the estimate." The auditors must recognize that a difference between an estimated amount best supported by the audit evidence and the estimated amount included in the financial statements may be reasonable and that such differences would not be considered to be a misstatement.

Recommendation

The Cabinet for Workforce Development (CWD) should look at current unemployment benefits paid and any extended benefits to claimants to reasonably determine the current benefits that will be paid after fiscal year-end. CWD should reevaluate the computations presented on the Accounts Payable Estimate benefits form, since the amounts on this form are reported on the AFR-70 closing package form.

Management's Response and Corrective Action Plan

DES attempts to make reasonable estimations based on the information available at the time AFR-70 is completed and due for inclusion in the closing package. However, more accurate information may become available during the time that the APA is conducting fieldwork. APA will be asked to provide additional guidance to assist DES personnel in making more accurate estimations in the future.

FINANCIAL STATEMENT FINDINGS***Reportable Conditions Relating to Internal Controls and/or
Reportable Instances of Noncompliance*****FINDING 02-CWD-3: The Cabinet For Workforce Development Should Strengthen
Controls Over Estimation Of Accounts Payable (Continued)**

Management's Response and Corrective Action Plan (Continued)

Pending further guidance from APA, the Benefit Payment Control Section will use actual figures from the Daily Check Register of payments made to claimants during the first week of July. Also, the actual figures from the Daily Check Register of payments made to claimants during the second week of July will be estimated at 50% of total checks paid. This action will be applied at this FYC [fiscal year closing]. See example below.

*Example: 1st week payables (W/E 06-21-03 through W/E 06-28-03)
 2nd week payables (W/E 06-28-03 through W/E 07-05-03)*

Auditor's Reply

Since the submission of CWD's response and corrective action plan, the auditors have met with CWD personnel to discuss this finding. CWD has found a different approach to providing the information needed to prepare the closing package. DES has concluded that they have the necessary information prior to submission of the closing package form to enable them to present a more reasonable estimate.

FINANCIAL STATEMENT FINDINGS

Reportable Conditions Relating to Internal Controls and/or Reportable Instances of Noncompliance

FINDING 02-CWD-4: The Cabinet For Workforce Development Should Strengthen The Security Of Administrator Accounts

Vulnerability testing of CWD servers revealed several instances of lax security over administrator accounts, resulting in the potential of servers being vulnerable to intrusion.

We examined 22 CWD servers that provided NetBIOS information and found the administrator accounts on all 22 servers had not been renamed or disabled. Since the administrator cannot be locked out, if the account is not renamed, the server could be vulnerable, if a potential intruder attempted to gain access by guessing the administrator password through a brute force attack.

Further, we examined the CWD servers for specific applications that could be vulnerable and found six (6) machines with port 1433 open. One (1) server allowed the auditors to gain "Master" access through SQL using the default administrator logon. This type of access would provide an unauthorized user with complete access to the application. In addition, the user would be granted local system account rights to the server on which the application resides.

Administrator accounts are very powerful and can allow full access to the system. Therefore, these accounts should be scrutinized to ensure they are adequately secured. At a minimum, the passwords for these accounts should be changed from the system defaults. Further, some administrator accounts can be renamed to help obscure them from an unauthorized user's view.

Recommendation

We recommend CWD review all servers to ensure the local administrator accounts have been changed from the default-naming conventions and require the use of a password. Further, all applications that might allow a user access to the system or to configuration settings should be reviewed to ensure default logons are not allowed.

Management's Response and Corrective Action Plan

We have checked all of our servers. All of the Administrator accounts have been changed from the default naming conventions and require the use of a password. We are in the process of reviewing all applications that might inadvertently allow a user to access the system or permit access to configuration settings to ensure that default logons are not allowed. We plan to be in compliance by June 30, 2003.

FINANCIAL STATEMENT FINDINGS***Material Weaknesses and/or Material Instances of Noncompliance*****FINDING 02-CWD-2: The Division Of Unemployment Insurance Should Have A Computer System In Place To Adequately Maintain Employer Accounts**

During testing of 105 delinquent employer contribution receivables and 56 deferred revenues, we discovered 95 that had the following errors:

- The Kentucky Employer's Quarterly Unemployment Insurance Tax and Wage Reports (UI -3) were posted without payment via electronic filing by employers that are called tape filers, which created a receivable; however, the payment was received timely, but was not posted into the Unemployment Insurance – Administration (UIA) Program 42 system until after June 30, 2002.
- Several employer accounts were either bankrupt or voided (inactive) and should not be considered as a receivable.
- Payments were posted as accounts payable and not to the quarterly return it applied to, which also created a receivable in the system. Also payments were posted to accounts payable that did not have a corresponding return in the system. However, upon further investigation, the return was found to have been received and in the KEWES system, but not posted to the employer's account in the Program 42 system.
- Wages were incorrectly read by the MFE system, and, when posted to the UIA Program 42 system, it incorrectly created a receivable.
- The employer paid the correct lower rate; however, the rate was not changed in the system.
- Amended returns were posted as receivables, instead of making journal entries to correct the original return.
- In some cases, the receivable or deferred revenue was no longer showing on the system. We noted that several people have the capability to make adjustments to employer accounts without an audit trail.

Furthermore, on the AFR 30 and 32 closing package forms, the agency did not use its Trial Balance of Employer Accounts to report the amount received, not earned (deferred revenue) as of June 30, 2002.

FINANCIAL STATEMENT FINDINGS

Material Weaknesses and/or Material Instances of Noncompliance

FINDING 02-CWD-2: The Division Of Unemployment Insurance Should Have A Computer System In Place To Adequately Maintain Employer Accounts (Continued)

We cannot rely on the UIA Program 42 system to provide accurate reports related to employer tax, including a Trial Balance of Delinquent Contributions.

An overstatement of receivables from delinquent employer contributions on the closing package forms in the amount of \$46,550,188 was reported to FAC and was posted into the MARS system for financial statement reporting.

The deferred revenue amount was not supported with verifiable information; however, an adjustment was not made because the amount reported on the closing package form was reasonable based on our testing.

Proper internal control dictates UI should have a computer system in place to adequately maintain employer accounts to ensure that information input into the system is accurate and reliable.

Generally Accepted Accounting Principles (GAAP) dictates that government funds recognize revenues in the accounting period in which they become susceptible to accrual – both measurable and available. Therefore, amounts that are available, but not otherwise measurable, should be reported as deferred revenue rather than as revenue.

Recommendation

Computer system and staff controls should be enhanced to ensure amounts reported on the closing package forms for financial statement purposes are accurate and reflect the correct employers account balances. Corrections to computer systems and additional system controls must be implemented to prevent the recurrence of programming errors that affect the employer accounts. The closing package form submitted by UI must be supported by balanced and verifiable documentation.

Management's Response and Corrective Action Plan

DES is very concerned about accurate records. It would be irresponsible for the agency to allow known errors to remain uncorrected; therefore, we are requesting a detailed list and any documentation pertaining to the 95 errors on employer contribution reports referenced by the auditor. Also, in an attempt to better understand the auditor's findings, DES is requesting a breakdown of each error found. DES is anxious to get these accounts corrected

FINANCIAL STATEMENT FINDINGS***Material Weaknesses and/or Material Instances of Noncompliance*****FINDING 02-CWD-2: The Division Of Unemployment Insurance Should Have A Computer System In Place To Adequately Maintain Employer Accounts (Continued)****Management's Response and Corrective Action Plan (Continued)**

Each of the bullets that the auditor noted are addressed below based on the information available from the bullets.

- 1. To help alleviate the problem of magnetic media Tax and Wage Reports (UI-3) being posted without payment which creates a receivable; the Branch is sending the checks to Revenue for processing and submission to the UIA database prior to submitting the wage and tax report data. However, this will not alleviate A Notice of Assessment creating for those employers using our Website to submit their wage and tax report. This is due to the programming that is currently in place. The agency would like to initiate a M-3 request to program a stopgap measure for the short term, but in the long term, providing the funding becomes available, a major programming and system rewrite will be necessary. Most current processes would have to be changed and linked to the KEWES system.*
- 2. Being void or bankrupt alone does not cause an account to cease being receivable. There is a list of criteria that must be met. Under the new process, any account, upon meeting the prescribed criteria, automatically becomes "pending uncollectible". This creates an activity for supervisor approval. Upon approval by the supervisor, the account becomes uncollectible and is removed from accounts receivable reports.*
- 3. If a payment is received with no report, or if that employer owes no money to this agency, it is processed as an overpayment and not assigned to any specific quarter. However, if after processing the overpayment the employer files a report where money is due, that overpayment will automatically be applied to the filed report and tied to that quarter/year.*
- 4. In the instances of the MFE system reading the tax data incorrectly and creating a payable and/or receivable the agency inserted an edit to the UIA database to ensure that payments are properly applied. Any reports failing these edit are returned to KEWES and place into workflow queues (inbox) for review.*
- 5. DES is requesting the employer's KEIN [Kentucky Employer Identification Number] for investigation and possible corrective action will be taken. The*

FINANCIAL STATEMENT FINDINGS***Material Weaknesses and/or Material Instances of Noncompliance*****FINDING 02-CWD-2: The Division Of Unemployment Insurance Should Have A Computer System In Place To Adequately Maintain Employer Accounts (Continued)****Management's Response and Corrective Action Plan (Continued)**

Agency understands that computer system controls should be enhanced to ensure amounts reported for financial statements purposes are accurate and reflect the correct employers account balances.

6. Employers are instructed to mail amended reports to a different P.O. Box, which is processed by the Department for Unemployment Insurance rather than the Revenue Cabinet. Additionally, the Revenue Cabinet has been requested to send any amended reports they receive to DES for processing. However, if an employer sends an amended report to Revenue and it is processed as an original report, it will automatically go into the "Contributory" queue in KEWES for review. Any employer with more than one report for the same quarter will end up in this queue for review.

7. There are several employees who have "on-line" ability to make corrections to accounts. No one has the ability to make a change without an audit trail. Any change made on the status screen of 42 (address, rate) creates a "Notice of Change". Any change made on the account receivable screen is reflected on a monthly report which shows the change that was made and the user ID of the person who made the change.

DES will continue to educate and work with staff and KRC (Kentucky Revenue Cabinet) to ensure the accurate processing of UI Tax Receipts.

Auditor's Reply

The auditors have provided DES with the specific documentation that was requested relating to our sample tested. We also would like to note that the new process that was discussed relating to void or bankrupt accounts that are deemed uncollectible was not in place during this audit period and will be looked at for the next fiscal year. As for the audit trail, we inquired and searched for the audit trail relating to specific adjustments during testing, but UI was unable to provide us with that information.

FINANCIAL STATEMENT FINDINGS

Other Matters Relating to Internal Controls and/or Instances of Noncompliance

FINDING 02-CWD-5: The Cabinet For Workforce Development Should Ensure All User Accounts On Its Agency Servers Are Necessary

While performing interim vulnerability tests of the CWD, we found several instances where it appears unnecessary accounts were established on servers or for applications.

We sought NetBios information from 26 machines within two CWD domains including the Primary Domain Controllers, Backup Domain Controllers, SQL servers, and NT servers. NetBIOS account information was obtained from 22 servers of those servers. We examined this information to search for disabled or unused user accounts. There were numerous accounts that had been disabled, whose password age was over the standard 30 days, or had never logged onto the system.

The auditor attempted a remote logon to known applications, using various combinations of default logon passwords. We were able to create a Telnet session through port 23, using the anonymous default login on one machine.

Intruders often use inactive accounts to break into a network. If a user account has not been used for a period of time, the account should be disabled until it is needed. This minimizes the possibility that an unauthorized user will use the account. An account should be deleted if it is not going to be reinstated. Further, default Administrator, Guest, and Anonymous accounts in operating system and applications are some of the first accounts that an intruder will attempt to use. Therefore, they should be assigned strong passwords or, if possible, renamed or removed immediately after installation.

Recommendation

We recommend that CWD review accounts on all servers to determine which accounts had no password change within the last 30 days. These accounts should be evaluated to determine if they are still valid accounts, required for a business-related purpose. If not, the accounts should be disabled or deleted as appropriate. Further, CWD should ensure that all machines with Telnet services running on them restrict access to default, anonymous, or guest logons.

Management's Response and Corrective Action Plan

The Cabinet for Workforce Development has been reviewing accounts on all servers to determine which accounts had no password change within the last 30 days. These accounts are being evaluated to determine if they are still valid accounts required for a business-related purpose. If not, the accounts will be disabled or deleted as appropriate. The Cabinet for Workforce Development has disabled Telnet services running on our machines except when it is necessary, and then we have restricted access to default, anonymous, or guest logons. We plan to be in compliance by June 30, 2003.

FINANCIAL STATEMENT FINDINGS

Other Matters Relating to Internal Controls and/or Instances of Noncompliance

FINDING 02-CWD-6: The Cabinet For Workforce Development Should Ensure That Security Information Leakage Concerning Agency Devices Is Minimized

CWD did not restrict critical information divulged by its network servers. During the examination of the CWD local area networks (LANs) security for FY 02, we discovered several instances where computers within the LANs provided information that could potentially help an intruder with developing details for an attack.

Using standard scanning tools, we reviewed the names and other remarks for all servers located within two (2) of CWD's domains. We noted that the naming convention of servers was not sufficiently ambiguous to disguise the function of some servers. Further, there were remarks for several computers that might catch an intruder's interest.

We also ran other vulnerability assessment tools twice during the fiscal year on 26 servers within the two (2) CWD domains to determine if they would return information on Local Security Authority (LSA); Password Policies; or Valid User, Group, or Share Lists. The following table depicts the number of servers that would provide this information.

Type of information	Number of computers	Percentage of 62 computer providing information
LSA	25	96%
Password Policies	25	96%
Valid User List	24	92%
Valid Group List	23	88%
Valid Share List	23	88%

Finally, we found 10 servers with port 2301 open. We were allowed to logon to the Compaq Insight Manager (CIM) application on seven (7) of these servers with the default administrator user id and password. This access provides too much information to a potentially unauthorized individual.

An agency's domain information that is accessible to the world at large through inquiry tools or default logons should be kept at a minimum. Agencies should ensure that information such as location, accounts associated with the server, data residing on the server, and the server's role is not divulged or is stated in the most minimal of terms. To accomplish this, an agency can set devices to not respond to certain types of inquiries, can use naming conventions that obscure the purpose of servers, can provide no comments on server activity, and can restrict access to default logons for applications.

FINANCIAL STATEMENT FINDINGS***Other Matters Relating to Internal Controls and/or Instances of Noncompliance*****FINDING 02-CWD-6: The Cabinet For Workforce Development Should Ensure That Security Information Leakage Concerning Agency Devices Is Minimized (Continued)****Recommendation**

We recommend that CWD restrict the information that is being provided by their LAN computers to anonymous users. First, the naming convention for servers should be altered to make them more ambiguous and any unnecessary comments associated with the servers should be removed. Second, boundaries should be placed on what types of responses servers provide based on certain inquiries. Third, the default logons for the CIM application should be changed.

Management's Response and Corrective Action Plan

We plan to change to a more ambiguous naming convention for our servers we expect this process to take time because we believe that certain applications access servers based on the server name therefore we need time to evaluate all the ramifications before instituting a more ambiguous naming convention. We have removed server remarks that provide information such as location, accounts associated with the server, data residing on the server, and the server's role. We will work with SDG Incorporated to eliminate security vulnerability. Compaq Insight Manager has been removed from all our servers. We plan to be in compliance by June 30, 2003

FINANCIAL STATEMENT FINDINGS

Other Matters Relating to Internal Controls and/or Instances of Noncompliance

FINDING 02-CWD-7: The Cabinet For Workforce Development Should Ensure That All Open Ports On Agency Servers Have A Business-Related Purpose

During the interim security vulnerability assessment testing for servers controlled by CWD, we found several CWD servers with ports open that may not have a specific business-related purpose. Due to the large number of issues, the findings are grouped below by port number and application.

Port 7 – Echo and Port 19 - Chargen

One (1) server had both ports 7 and 19 open. These ports are not necessary for the function of the server and could potentially be used to perpetuate a Denial of Service (DoS) attack.

Port 13 – Daytime and Port 17 – Quote of the Day

One (1) server had both ports 13 and 17 open. These ports usually do not have a business-related purpose and can be abused by potential unauthorized users.

Port 42 – Host Name Server (HNS) and Port 53 – Domain Name Server (DNS)

We found one (1) server that was running both HNS and DNS service; another server also had the DNS service running. These services resolve the host/domain names for users and should be properly and consistently managed and coordinated with GOT services.

Port 80 – Hypertext Transfer Protocol (HTTP)

Port 80 was open on two (2) computers that would not display the website. When no default page or restricted logon is required, normally this means that no application/web service is running at the port.

Port 443 – Hypertext Transfer Protocol over Secure Socket Layer (HTTPS)

One (1) server was found with port 443 open but would not display a website. When no default page or restricted logon is required, normally this means that no application/web service is running at the port.

Port 548 – Apple File Protocol (AFP)

One (1) server was found with port 548 open. The AFP should not be used unless Apple computers are connected to the network.

Port 6667 – Internet Relay Chat

Two (2) servers were discovered with port 6667 open. This port can be used for several serious exploitations, such as DoS attacks, Trojan horse attacks, and downloading of illegal files. This port could be useful to a hacker and should only be used for a necessary business-related application.

FINANCIAL STATEMENT FINDINGS

Other Matters Relating to Internal Controls and/or Instances of Noncompliance

FINDING 02-CWD-7: The Cabinet For Workforce Development Should Ensure That All Open Ports On Agency Servers Have A Business-Related Purpose (Continued)

Port 8000 – HTTP

Two (2) servers were discovered that had port 8000 open. One (1) of these servers did not display the website. This server does not appear to have an application/web service running. The remaining server revealed configuration information for printers/print servers. This situation allows too much access to an unauthorized user.

Other Ports

Seven (7) servers had ports open that do not appear to specifically relate to known business applications. CWD should review all open ports on servers to ensure that all have a valid business-related purpose.

The existence of open ports is an invitation for intruders to enter your system. To minimize the risk of unauthorized access to a computer, only necessary, business-related ports should be open and all applications residing at these ports should be secured to the extent possible.

Recommendation

We recommend that CWD perform a review of all open ports on the servers discussed in this comment. If there is not a specific business-related purpose requiring a port to be open, then that port should be closed. Further, we recommend that CWD begin a periodic review of open ports on all computers owned by the agency to ensure necessity.

Management's Response and Corrective Action Plan

We have checked our servers, disabled the telnet services, removed Insight Manager and we are in the process of scanning all servers in our domain to identify and close any remaining unnecessary open ports. After some preliminary IP to address resolution procedures, based on the report given to us from the auditors' office, we found that many of the addresses were not server addresses. Some of the addresses were DHCP client workstations. We are investigating making future modifications to our firewalls to block ports. We plan to be in compliance by June 30, 2003.

FINANCIAL STATEMENT FINDINGS

Other Matters Relating to Internal Controls and/or Instances of Noncompliance

FINDING 02-CWD-8: The Cabinet For Workforce Development Password Policy Should Be Consistently Applied To All Local Area Network Servers

As was noted in the prior audit, password policies established on certain critical CWD servers did not adhere to the agency password policies. During the FY 2002 audit, we attempted to obtain the password policies of all Primary Domain Controllers (PDC), Backup Domain Controllers (BDC), Structured Query Language (SQL), and a sample of Network servers within the two (2) domains maintained by CWD using a vulnerability assessment tool. Of the 26 servers reviewed, the auditor was able to obtain the password policies for 25 of these servers, or 96 percent.

It was found that the password policies established on servers within two (2) CWD domains did not agree to the recommended password policy. See table below for findings.

Security Measure	GOT or Industry Standards	Number of servers not in compliance with policy	Percentage of 25 servers not in compliance with policy
Maximum Age	30 days	11 – 42 days 12 – 60 days	92%
Minimum Age	1 day	23 – None	92%
Minimum Length	8 characters	11 – None 2 – 6 characters	52%
Lockout Threshold	3 attempts	21 – None	84%
Lockout Duration	“Forever”	9 – 30 minutes 1 – 999 minutes 1 – 99999 minutes	44%
Lockout Reset	1,440 minutes	1 – 999 minutes 2 – 120 minutes 9 – 30 minutes 12 – 10 minutes	96%

The NetBIOS information from the 25 servers was examined to determine if accounts adhered to the Policy. We found user, guest, and administrator accounts on 22 servers, or 88 percent of reviewed servers, which had logged onto the system, but did not comply with the standard to change an account password at least every 30 days.

Currently, CWD has a security policy that is in draft form. This policy briefly describes password policies; however, it is not complete and has not been issued to the agency at large.

FINANCIAL STATEMENT FINDINGS***Other Matters Relating to Internal Controls and/or Instances of Noncompliance*****FINDING 02-CWD-8: The Cabinet For Workforce Development Password Policy Should Be Consistently Applied To All Local Area Network Servers (Continued)**

Passwords are a significant feature to guard against unauthorized system access. The failure to follow adequate password policy standards when establishing a system password could ultimately compromise the entire network. The purpose of a password policy is to establish a standard to create strong passwords, to protect those passwords, and to ensure passwords are changed within a specified time period. To assist in the security of a network, it is necessary for a strong policy to be developed and consistently implemented on all servers throughout the network.

Recommendation

We recommend that CWD review all servers within their agency-owned domains to ensure that the password policy established complies with the policy guidelines recommended by either GOT or industry standards and that all user accounts comply with those established policies. Further, CWD should review its security policy to ensure that the established password policies are included. Efforts should also be made to ensure the security policy is finalized and issued to all employees.

Management's Response and Corrective Action Plan

We have changed the Administrator password on all of our servers. We have set our user passwords to change every 30 days. We have started to review our security policy to ensure that the established password policies are included. Efforts are also being undertaken to ensure the security policy is finalized and issued to all employees. Workforce will continue to review all servers within our agency-owned domains to ensure that the password policy established complies with the policy guidelines recommended by either GOT or industry standard, and that all user accounts comply with those established policies. We plan to be in compliance by June 30, 2003.

FINANCIAL STATEMENT FINDINGS

Other Matters Relating to Internal Controls and/or Instances of Noncompliance

FINDING 02-CWD-9: The Cabinet For Workforce Development Should Remove The Simple Network Management Protocol Service Or Change The Default Community String

While performing interim system vulnerability tests at the CWD, we found eight (8) servers, or 30.7 percent of the 26 servers examined, that had the Simple Network Management Protocol (SNMP) service available and would allow an anonymous user to logon with the community name “public.” The “public” community name is the default public account for this service. The use of the “public” community name allows too much information to be provided to any anonymous user. Through our testing, the system provided information about listening ports, open sessions, active user accounts, and shares that exist.

Information provided by the SNMP service concerning a machine’s functions could be useful to an intruder in developing an attack. Worldwide access through default logons should not be allowed. To accomplish this, the agency should change the SNMP service default community names.

Recommendation

We recommend that CWD either disconnect the SNMP service or change the “public” community name to a more sophisticated name on all servers. Further, any new computers should be checked for the SNMP service to ensure the “public” community name has been changed.

Management’s Response and Corrective Action Plan

SNMP is unused by any of the servers we currently have deployed. We have removed SNMP from all of our servers.

FINANCIAL STATEMENT FINDINGS***Other Matters Relating to Internal Controls and/or Instances of Noncompliance*****FINDING 02-CWD-10: The Cabinet For Workforce Development Should Strengthen The Logical Security Procedures For The Kentucky Electronic Workplace For Employment Services**

During our examination of the logical security procedures in place over the Kentucky Electronic Workplace for Employment Services (KEWES), the auditor found that CWD security access forms required to grant system access were not consistently available. CWD was able to only provide supporting documentation for eight (8) users out of a sample of 25, or 32 percent. Further, the documentation on file did not consistently provide proof of supervisor approval.

The lack of supporting documentation seems to have occurred for several reasons. First, the "Request for KEWES Account" form was not being consistently used. Requests were being sent in through e-mail that was not properly maintained. Second, the security administrator in place during FY 02 left the position and some of her documentation was unavailable. Third, one (1) of the new security administrators was maintaining e-mailed requests for KEWES access on his personal computer hard drive. The hard drive in question crashed and the information on it was unrecoverable.

As of October 2002, a new procedure for the requisition of KEWES access was put into operation. A revised CWD RACF Request form was implemented that includes a section for identifying required KEWES access. Procedures are in place to require all approvals to be available prior to any actions being taken on the form. DES maintains these forms electronically.

Consistent application of established security policies and procedures provides continuity for policy implementation, and sets the tone of management concern for a strong system to secure assets and resources. Further, documentation should be available to verify proper authorization of the system access granted.

Recommendation

We recommend that CWD strictly adhere to the new process for requesting KEWES access. Further, all requests in electronic format should be maintained on a server that is backed up on a daily or weekly basis to ensure that supporting documentation can be retrieved in case of system failure.

FINANCIAL STATEMENT FINDINGS

Other Matters Relating to Internal Controls and/or Instances of Noncompliance

FINDING 02-CWD-10: The Cabinet For Workforce Development Should Strengthen The Logical Security Procedures For The Kentucky Electronic Workplace For Employment Services (Continued)

Management's Response and Corrective Action Plan

We accept the auditor's recommendation and will employ strict adherence to the new system that was put into place October 2002. The following process will be followed when requesting KEWES access.

Revised RACF Request form was implemented in October 2002 to include the request for KEWES access with supervisor signature for approval.

As recommended, Electronic copies of the RACF request will be kept on the local server that is backed up on a weekly basis for record purposes.

We plan to run a disaster recovery test on KEWES in March of 2003.

FEDERAL AWARD FINDINGS AND QUESTIONED COSTS***Reportable Conditions Relating to Internal Control and/or
Reportable Instances of Noncompliance*****FINDING 02-CWD-11: The Department For Training And ReEmployment Did Not Reconcile Subrecipient Expenditures To MARS**

State Agency: Cabinet For Workforce Development

Federal Program: CFDA 17.255 – Workforce Investment Act

Federal Agency: U.S. Department of Labor

Pass-Through Agency: Not Applicable

Compliance Area: Reporting

Amount of Questioned Costs: None

Financial Status Reports (FSR) for Local Administration, Local Adult, Local Dislocated Worker, Local Youth, Rapid Response, and Local Statewide Activities expenditures do not reconcile to MARS. The Department for Training and ReEmployment (DTR) uses expenditure reports prepared by the Local Workforce Investment Areas (LWIA) to report local expenditures on the FSR. The expenditure data recorded in MARS only reflects the amounts reimbursed to LWIAs and has not been updated to reflect actual expenditures in the appropriate categories.

DTR has implemented its corrective action procedures to identify local expenditures for the three (3) funding streams: Adult, Dislocated Worker, and Youth Activities. DTR is currently making adjustments to open grants to accurately reflect expenditures in the correct grant/project number in MARS. However, the corrective action procedures do not allow for drawdown requests to distinguish between Local Administration, Local Rapid Response, and Local Statewide Activities from the three (3) local expenditure categories.

Reports submitted to the U.S. Department of Labor (USDOL) are not supported by the Commonwealth's official accounting system--MARS. LWIA expenditures have not been updated in MARS to accurately reflect expenditures by the subrecipients.

Proper internal controls dictate agencies maintain adequate supporting documentation for reports submitted to the federal government. MARS is the official record of expenditures. Further, DTR procedures indicate that this update of MARS should occur at least quarterly.

FEDERAL AWARD FINDINGS AND QUESTIONED COSTS***Reportable Conditions Relating to Internal Control and/or
Reportable Instances of Noncompliance*****FINDING 02-CWD-11: The Department For Training And ReEmployment Did Not Reconcile Subrecipient Expenditures To MARS (Continued)**

Recommendation

We recommend DTR implement procedures to distinguish Local Administration, Local Rapid Response, and Local Statewide expenditures from the Local Adult, Dislocated Worker, and Youth Activities. DTR should fully use the capabilities of MARS to track grant expenditures, so that the Commonwealth's accounting system fully supports expenditures as submitted in federal reports. Additional activity codes or subprojects could be established to track these expenditures within the three (3) funding streams, and DTR should implement new drawdown requests to allow LWIAs to request funds from the appropriate category. Journal vouchers could be used to correct expenditures for Local Administration on a quarterly basis when the amounts are known.

Management's Response and Corrective Action Plan

DTR will implement a policy to update the MARS system quarterly to reflect LWIA reported expenditures as Statewide 15%, Rapid Response, Local Administration, Local Adult Program, Local Youth Program, and Local Dislocated Worker Program. We disagree with the suggestion to revise the drawdown request because it would be counterproductive to revise the drawdown process to have the LWIAs access their funds according to budget line item rather than by project. The process of entering the expenditures would be excessively demanding for the staff involved and the local area staff would be unable to accurately classify their expenditures in advance of the funding request. If expenditures were to be reclassified the amounts would have to be refunded through a check and the funds accessed through electronic fund transfer under another category. We do not have the capability to receive funds electronically as credits.

FEDERAL AWARD FINDINGS AND QUESTIONED COSTS***Reportable Conditions Relating to Internal Control and/or
Reportable Instances of Noncompliance*****FINDING 02-CWD-12: The Department For Training And ReEmployment Should Implement Additional Procedures To Ensure Subrecipient Findings Are Followed Up On In A Timely Manner**

State Agency: Cabinet For Workforce Development

Federal Program: CFDA 17.255 – Workforce Investment Act

Federal Agency: U.S. Department of Labor

Pass-Through Agency: Not Applicable

Compliance Area: Subrecipient Monitoring

Amount of Questioned Costs: None

During the FY 02 audit, we tested the audit log maintained by DTR to track subrecipient monitoring related to the required audits of subrecipients. During this review, we noted the following:

- DTR did not obtain and resolve the subrecipient audit reports in a timely manner.
- DTR does not have any way of determining when LWIAs receive the audit reports to ensure they comply with federal regulations on submitting them timely.
- Agency records were not reconciled to the subrecipients' audited financial statements. The reconciliation process was started; however, the differences had not been resolved.

DTR has implemented its corrective action plan as stated in the prior year response to the same finding. DTR has reassigned the responsibilities of monitoring subrecipient audit reports to the Program Compliance and Support Branch. The Financial and Program Operations Branch provided technical assistance in performing the reviews and reconciliations; however, this training was not complete until June 2002.

The effects of the weaknesses noted above include:

- The receipt of the audit reports in an untimely manner delays the entire resolution process. It also increases the likelihood that subrecipient weaknesses noted in the audit continue for a longer period of time since they are not being addressed.
- When agency records are not reconciled to audited financial statements, amounts used for federal reporting may be erroneous.

FEDERAL AWARD FINDINGS AND QUESTIONED COSTS***Reportable Conditions Relating to Internal Control and/or
Reportable Instances of Noncompliance*****FINDING 02-CWD-12: The Department For Training And ReEmployment Should Implement Additional Procedures To Ensure Subrecipient Findings Are Followed Up On In A Timely Manner (Continued)**

According to OMB Circular A-133, the funding agency should be sent a copy of the audit report within the *earlier* of 30 days after [the subrecipient's] receipt of the auditor's report(s), or 9 months after the end of the audit period. This requirement is also outlined in DTR's Audit Resolution Guide and is in effect for fiscal years beginning after June 30, 1998. [OMB Circular A-133 Part 4 Subpart B, Sec 235 (c) (1).]

The Workforce Investment Act (WIA) regulations state, "The Governor is responsible for resolving findings that arise from the State's monitoring reviews, investigations and audits (including OMB Circular A-133 audits) of subrecipients." [20 CFR 667.500 (a) (1) and (2).]

Further, according to OMB Circular A-133, pass-through entities are responsible for issuing a management decision on audit findings of subrecipients within six (6) months after receipt of the audit finding. [OMB Circular A-133; Subpart D Sec 400 (d) (5)] If corrective action has not been completed at that time, a timetable for follow-up may be included. [OMB Circular A-133; Subpart D Sec 405 (a)]

Recommendation

We recommend CWD and DTR implement procedures to ensure compliance with WIA regulations, OMB Circular A-133, and DTR guidelines regarding audit resolutions of subrecipients. We also recommend DTR obtain documentation regarding the date on which the subrecipients received the audit reports to ensure DTR receives the audit in accordance with OMB Circular A-133 requirements.

Management's Response and Corrective Action Plan

Eighty (80) percent of the audit reports have been received and acted upon as of March 4, 2003. Reconciliations have been requested of LWIAs as required. Final determinations have been issued to 50% of LWIAs which have submitted audits. The remaining two LWIAs which have not submitted audits are expected to do so by March 30, 2003, nine months after the end of the audit period. To ensure that the LWIAs meet the submission requirements of OMB Circular A-133 [Subpart B, Sec 235 © (1).], DTR will send the LWIAs a reminder letter in August of each fiscal year to reiterate the submission requirements for the previous year's audit reports.

FEDERAL AWARD FINDINGS AND QUESTIONED COSTS***Reportable Conditions Relating to Internal Control and/or
Reportable Instances of Noncompliance*****FINDING 02-CWD-12: The Department For Training And ReEmployment Should Implement Additional Procedures To Ensure Subrecipient Findings Are Followed Up On In A Timely Manner (Continued)**

Management's Response and Corrective Action Plan (Continued)

DTR will require the local areas to date-stamp their audit report to verify that the Department, then, received the audit report within thirty (30) days, or by March 31st, whichever is earlier. DTR will send another reminder letter to each LWIA individually on the anniversary date of receipt of their previous year's audit to again reiterate the submission requirements. To document that the LWIAs are in compliance with the submission date, DTR will compare the date on the audit report with the date the audit was received by DTR. Noncompliance with the submission requirements will result in an administrative finding being issued to the LWIA.

FEDERAL AWARD FINDINGS AND QUESTIONED COSTS***Reportable Conditions Relating to Internal Control and/or
Reportable Instances of Noncompliance*****FINDING 02-CWD-13: The Division Of Unemployment Insurance Should Ensure
Federal Reports Are Supported By Accurate And Reliable Data**

State Agency: Cabinet For Workforce Development

Federal Program: CFDA 17.225 – Unemployment Insurance

Federal Agency: U.S. Department of Labor

Pass-Through Agency: Not Applicable

Compliance Area: Reporting

Amount of Questioned Costs: None

The Employment and Training Administration (ETA) 581 form is inaccurately stated due to double adjustments made from noncompliance with UI procedures. UI is not complying with the established procedures to audit the processed payments before making adjustments. Tax data is entered from the employer quarterly reports. During the process of auditing these reports, UI will determine if the information posted to the accounting system is in error. The erroneous data will be deleted and the correct information entered. These transactions are not reflected in the accounts receivable activity report, which is the source document for the ETA 581. Auditing of reports is not being completed prior to the end of the quarter when the source document is generated. Thus, the accounts receivable activity report used as a source document for the ETA 581 is not a reliable indicator of actual receivables.

The information reported to the federal government on the ETA 581 was found to be inaccurate and unreliable. This information can affect ranking and funding for the state. The data is used in a quarterly publication called *State Performance Rankings* as performance indicators for national and regional office staff. This data is also used to evaluate whether or not states are meeting various tax performance measures and in the determination of workloads within each state for allocation of administrative funding from the USDOL to each state.

Proper internal controls dictate that accurate and reliable information be presented when preparing and transmitting federal reports. Reports should be adequately supported with valid and accurate documentation. All measures should be taken to ensure that the information being reported is as accurate as possible.

Per the USDOL, all states are required to implement a data validation (DV) program by July 31, 2003 that will validate reports that are submitted to the national office. This report, ETA 581, is one of the reports that this will validate. Based upon USDOL correspondence, this program will validate the accuracy of this report.

FEDERAL AWARD FINDINGS AND QUESTIONED COSTS***Reportable Conditions Relating to Internal Control and/or
Reportable Instances of Noncompliance*****FINDING 02-CWD-13: The Division Of Unemployment Insurance Should Ensure
Federal Reports Are Supported By Accurate And Reliable Data (Continued)**

Recommendation

We recommend that adequate controls be implemented to ensure erroneous or double adjustments are not made to employer accounts without there being an audit trail to follow. Audit activity needs to be performed to ensure the returns and adjustments are audited within a reasonable time to help eliminate the double adjustments and erroneous data.

We recommend the DV program be completed on time to be in compliance with USDOL initiatives.

Management's Response and Corrective Action Plan

We agree with the finding that mainframe tax accounting source documents do not provide an accurate reconciliation of accounts receivable data for federal reporting purposes. We believe that the problem does not lie with the accounting system itself, but with the inability of the tax accounting staff to complete a timely audit of employer tax reports so that accurate data would exist on the mainframe as of the reporting date. The problem is further exacerbated by erroneous adjustments made by other tax staff based on unaudited accounting data. The cascade effect of errors compounding other errors has persisted now for several quarters, with the result that the mainframe accounting system is confounded with errors.

The simple explanation of how we arrived at this situation is the systemic neglect of staffing in the tax accounting section (and indeed throughout the tax branches) for many years. At its peak the tax branches (when they were a consolidated agency) employed 125 staff, with some 80 devoted to central office functions and approximately 20 in the accounting area alone. Today the entire UI tax program (field audit staff included) employs fewer staff than once worked in central office alone, and the accounting area is staffed with fewer than 10 full-time permanent state employees. Meanwhile our employer population, and the attendant accounting work, has increased.

Nor are staff numbers alone the source of the problem. Over the past five years we have lost nearly all of the long-term experienced staff in the tax program to retirement and other employment. The "institutional amnesia" resulting from the rapid depletion of our knowledge base has been severely damaging to our ability

FEDERAL AWARD FINDINGS AND QUESTIONED COSTS***Reportable Conditions Relating to Internal Control and/or
Reportable Instances of Noncompliance*****FINDING 02-CWD-13: The Division Of Unemployment Insurance Should Ensure
Federal Reports Are Supported By Accurate And Reliable Data (Continued)**

Management's Response and Corrective Action Plan (Continued)

to maintain the work of the accounting area. When staff have been hired to replace those who have left, too often they have been temporary or interim workers who have not stayed long enough to acquire even a rudimentary understanding of the complexities of the tax accounting system and processes. Today there is no staff person in the tax accounting area who actually possesses professional accounting education or holds a title of graduate accountant. (Moreover, a previous UI Director did not deem it necessary that the supervisor over the accounting section should have an accounting background, a situation that persists!)

The impossibility of maintaining the workload in the tax accounting area with remaining staff has forced us to take extreme measures to reengineer the way in which we do business. These measures, taken in tandem, have been to employ radically different technology to perform the report auditing function; and to outsource the front-end processing of employer tax reports and payments to the Kentucky Revenue Cabinet. (We have also outsourced the entry of wage information to a private company when we were no longer allowed to use the services of Kentucky Correctional Industries to perform this task. The disruption resulting from this mandatory change put us even further behind.) Ultimately these changes will allow us to perform the tax accounting functions in a more efficient and cost-effective fashion. However, the process of the changes themselves have required considerable time (our reengineering project – KEWES – has been underway since July 1999) and engender more delays as staff learn to do business in new ways. Also, the reliance on business partners such as Revenue and the Governor's Office for Technology to perform more and more of the work we once performed ourselves means that we cannot control the entire process and must negotiate for priorities among competing responsibilities of those partner agencies.

Having reviewed the problems that put us where we are today, the solution is straightforward. We have established new processes and implemented new technology to gain all the efficiency possible. We will continue to work with the Revenue Cabinet to ensure that they provide the most timely processing of reports as possible, because until their work is done we cannot begin ours. We will continue to work with GOT and with our KEWES technology business partners to

FEDERAL AWARD FINDINGS AND QUESTIONED COSTS***Reportable Conditions Relating to Internal Control and/or
Reportable Instances of Noncompliance*****FINDING 02-CWD-13: The Division Of Unemployment Insurance Should Ensure
Federal Reports Are Supported By Accurate And Reliable Data (Continued)**

Management's Response and Corrective Action Plan (Continued)

ensure that the information technology systems and network upon which are dependent are as reliable as the state of the art will allow. We will implement barriers in the tax accounting system to reduce the potential for erroneous adjustments by limiting access to unaudited data. However, after all these actions have been taken, we still require the staff to get the work done. The tax accounting area must be staffed not only with an adequate number of workers to complete their tasks on time, but those staff need to be appropriately educated and classified and permanent so that the investment in their training is not continually lost. The accounting area must be effectively managed by supervisors who thoroughly understand both the processes under their direction and the necessity of completing those processes on time. The upper management of DES must be responsive to the need to commit additional resources to this area when required to get the job done.

Once this occurs – and we are committed to seeing that it does – the information committed to the mainframe tax accounting system will at last be reliable, and accounts receivable data can be reconciled again for federal reporting. We will review the historical accounting records for errors remaining from the years in which this has not been the case. This cannot happen overnight. But it will happen.

FEDERAL AWARD FINDINGS AND QUESTIONED COSTS***Reportable Conditions Relating to Internal Control and/or
Reportable Instances of Noncompliance*****FINDING 02-CWD-14: The Division Of Unemployment Insurance Should Implement Procedures To Ensure The Accuracy And Timeliness Of The IRS 940 Federal Unemployment Tax Administration Certification**

State Agency: Cabinet For Workforce Development

Federal Program: CFDA 17.225 – Unemployment Insurance

Federal Agency: U.S. Department of Labor

Pass-Through Agency: Not Applicable

Compliance Area: Special Tests and Provisions

Amount of Questioned Costs: None

During the audit of the Internal Revenue Service (IRS) 940 Federal Unemployment Tax Administration (FUTA) Match/Certification, we discovered that the date on the transmittal sheet was approximately seven (7) months past the due date. In FY 01, we were unable to do any testing on the 1999 FUTA Certification, as it was not transmitted until July 31, 2002. For the FY 02 audit, the certification was due on January 31, 2002, and it was not transmitted to the federal government until August 9, 2002. The IRS is not able to provide information to UI until September or November of the following year. Therefore, for FY 02, the 2000 certification should be performed at that time and submitted back to the IRS by January of the following year. The reason for UI's late submission was due to problems with reconciling the trial balance. This has been an issue in previous audits and continues to be a problem. UI has trouble getting the trial balance to reconcile to agency ledgers due to continual adjustments to employer accounts.

In addition, review of the supporting documentation showed that the trial balance amounts of taxable payroll were off by approximately \$16 million from the certification report. UI was unable to provide the auditors with the reason for this discrepancy, other than the knowledge that employer's taxable payroll amount exceeded the character width of the program. UI knew about the character width issue, but never corrected it due to the cost and inconvenience to adjust the program's character width.

An untimely report submission can affect the taxpayer's ability to take advantage of the FUTA tax credit. Also, not reporting timely can have an adverse reaction because of delays in taxpayers receiving notices of proposed tax increases/decreases, any refunds for decreases, or tax bills.

FEDERAL AWARD FINDINGS AND QUESTIONED COSTS***Reportable Conditions Relating to Internal Control and/or
Reportable Instances of Noncompliance*****FINDING 02-CWD-14: The Division Of Unemployment Insurance Should Implement Procedures To Ensure The Accuracy And Timeliness Of The IRS 940 Federal Unemployment Tax Administration Certification (Continued)**

An inaccurate presentation of information from the certification run does not show the actual differences between UI's trial balance and the federal government's report. The 2000 certification spreadsheet does not present an accurate picture of the information UI received. Presenting inaccurate information could affect the course of action the federal government takes.

The IRS Document 6581 outlines the deadlines for the preparation of this certification. The deadline for this report is January, and it states that it is critical that this be met. 26 CFR 31.3302(a)-3(a) requires the state to provide this annually.

Proper internal controls dictate that accurate and reliable information be presented when preparing and transmitting federal reports. Reports should be adequately supported with valid and accurate documentation. All measures should be taken to ensure the information being reported is as accurate as possible.

Recommendation

We recommend UI implement controls to ensure the annual IRS 940 FUTA certification is performed timely and accurately.

We also recommend UI work to get the character width corrected to prevent this error in the report. This correction helps to ensure UI's trial balance agrees to the federal government's data and accurately show where there are discrepancies with this information.

Management's Response and Corrective Action Plan

The Agency agrees with the recommendation that the Federal Certification should be timely to avoid adverse reactions for employers. The trial balance total for taxable payroll was \$16 million more than the certification; therefore, the character width of the program is not an issue. GOT and the Division are currently working on identifying the discrepancy. After analyzing the discrepancy the Agency will put into place the necessary steps to help avoid future discrepancies.

FEDERAL AWARD FINDINGS AND QUESTIONED COSTS***Other Matters Relating to Internal Controls and/or Instances of Noncompliance*****FINDING 02-CWD-15: The Department For Training And ReEmployment Should Ensure That Accurate Project Codes Are Being Utilized When Preparing Timesheets**

State Agency: Cabinet For Workforce Development

Federal Program: CFDA 17.255 – Workforce Investment Act

Federal Agency: U.S. Department of Labor

Pass-Through Agency: Not Applicable

Compliance Area: Activities Allowed or Unallowed

Amount of Questioned Costs: None

During the testing of the agency's payroll, the auditor discovered that grant project codes indicated on some of the timesheets did not agree with the Uniform Personnel Payroll System (UPPS) reports. The three (3) instances noted for the current year relate to the first part of the fiscal year, as the agency has implemented its corrective action plan from our FY 01 audit findings and is reviewing the timesheets for accuracy.

If the incorrect grant projects are charged during the payroll process, it is possible to over expend or charge to a grant that is closed. By not charging employee time to the correct grants, the time devoted specifically to the performance of an award cannot be identified.

According to OMB Circular A-87, charges to federal awards for salaries and wages, whether treated as direct or indirect cost, will be based on payrolls documented in accordance with generally accepted practice of the governmental unit and approved by a responsible official(s) of the governmental unit. Where employees work on multiple activities or cost objectives, a distribution of their salaries or wages will be supported by personnel activity reports. These reports must account for the total activity for which each employee is compensated.

Recommendation

Timesheets should be updated each pay period with the correct grant project codes so that each grant is properly charged. Adequate controls should continue to be implemented to ensure timesheets are reviewed each pay period and the payroll administrator should record the accurate payroll data into the UPPS system.

Management's Response and Corrective Action Plan

Timesheets will be reviewed each payroll period to ensure that the correct grant project codes are utilized and that each grant is properly charged.

FEDERAL AWARD FINDINGS AND QUESTIONED COSTS*Other Matters Relating to Internal Controls and/or Instances of Noncompliance***FINDING 02-CWD-16: The Department For Training And ReEmployment Should Implement Procedures To Ensure Subrecipient Monitoring Reports Are Issued Within A Timely Manner**

State Agency: Cabinet For Workforce Development

Federal Program: CFDA 17.255 – Workforce Investment Act

Federal Agency: U.S. Department of Labor

Pass-Through Agency: Not Applicable

Compliance Area: Subrecipient Monitoring

Amount of Questioned Costs: None

During testing of DTR compliance with federal regulations and internal policies regarding the monitoring of subrecipients, the auditor noted the following:

- Three (3) responses from LWIAs were not received on a timely basis. The tardy responses included Bluegrass LWIA and Northern Kentucky LWIA responses to the Initial Determination. Also, the Jefferson/Louisville LWIA has not submitted a response to the Initial Determination. The monitoring file shows documentation of an extension granted until November 4, 2002; however, there has not been consistent follow up by DTR when the response was not received.
- Two (2) final reports were not issued within thirty days of receiving the LWIA response to the Initial Determination or sixty days if no response was received. The final report for Louisville/Jefferson LWIA has not been issued although the response from this LWIA was not received. The final report not issued timely was for North Central Kentucky LWIA

The continued occurrence of late reports and subrecipient responses indicates that corrective procedures implemented have not sufficiently corrected the problem.

Untimely reports and responses constitute a control weakness and violates DTR policies regarding monitoring and reporting.

Unresolved monitoring findings could result in subrecipients spending federal funds in violation of federal regulations.

The federal regulations for WIA require monitoring of subrecipients. Specific monitoring policies are to be set by the monitoring agency. DTR has determined the internal policies regarding the timing of monitoring site visits, issuance of reports, and guidelines for response deadlines in order to comply with the federal regulations. These policies have been outlined in Information Memo #33, dated July 18, 2000. The auditor has determined that the above-mentioned exceptions are in violation of the DTR policy.

FEDERAL AWARD FINDINGS AND QUESTIONED COSTS***Other Matters Relating to Internal Controls and/or Instances of Noncompliance*****FINDING 02-CWD-16: The Department For Training And ReEmployment Should Implement Procedures To Ensure Subrecipient Monitoring Reports Are Issued Within A Timely Manner (Continued)**

Recommendation

The auditor recommends that DTR review procedures currently in place and implement procedures to ensure that all monitoring reports are issued in a timely manner. We also recommend that the agency notify the LWIA of response deadlines prior to the due date.

Management's Response and Corrective Action Plan

DTR has formulated a corrective action plan which includes a new form to more accurately track monitoring reports and timelines, and revision of report issuance policy to allow for more time for DTR to generate reports and the LWIAs additional response time. The improved form to track the monitoring reports by date of issuance and required response has already been implemented. The revision of reporting policy will be implemented soon.

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2002

Fiscal Year	Finding Number	Finding	CFDA Number	Questioned Costs	Comments
<u>Reportable Conditions</u>					
<i>(1) Audit findings that have been fully corrected:</i>					
FY 01	01-CWD-1	The Division Of Unemployment Insurance Did Not Report Deferred Revenues	NA	0	Resolved during FY 02.
FY 01	01-CWD-7	The Department For Training And ReEmployment Did Not Reconcile Financial Status Reports To MARS	17.255	0	Resolved during FY 02.
FY 01	01-CWD-8	The Department For Training And ReEmployment Did Not Reconcile Subrecipient Reports	17.255	0	Resolved during FY 02.
FY 01	01-CWD-9	The Department For Training And ReEmployment Did Not Monitor Timesheets To Ensure The Correct Project Code Was Being Charged	17.255	0	Resolved during FY 02.
FY 01	01-CWD-12	The Department For Training And ReEmployment Did Not Correctly Report Some Amounts For JTPA Closeout	17.250	0	Resolved during FY 02.
FY 00	00-CWD-6	The Department For Training And ReEmployment Should Comply With JTPA Regulations And OMB Circular A-133 Regarding Resolution Of Subrecipient Audit Findings	17.246 17.250	0	Resolved during FY 02.
FY 00	00-CWD-8	The Department For Training And ReEmployment Should Complete The Process Of Reviewing Subrecipient Invoices And Updating MARS To Accurately Reflect Actual WIA Expenditures	17.255	0	Resolved during FY 02.
FY 99 FY 02	99-CWD-7	The Department For Employment Services Should Implement Controls To Ensure All Applicable Regulations And Program Policies Are Followed In Their Administration Of Federal Programs	17.246	613,950 (613,950)	Resolved during FY 02. USDOL dismissed the questioned costs.
Total Questioned Costs				0	

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2002

Fiscal Year	Finding Number	Finding	CFDA Number	Questioned Costs	Comments
<u>Reportable Conditions (Continued)</u>					
<i>(2) Audit findings not corrected or partially corrected:</i>					
FY 01	01-CWD-2	The Division Of Unemployment Insurance Allowance For Uncollectible Accounts Was Not Updated For Current Year Actions	NA	0	See 02-CWD-1
FY 01	01-CWD-3	The Cabinet For Workforce Development Should Improve Local Area Network Server Security And Consistently Apply Policies To All Servers	NA	0	Six new formal findings were issued for FY 02 regarding specific areas of LAN server security. Only one finding is a reportable condition. See 02-CWD-4.
FY 01	01-CWD-10	The Division Of Unemployment Insurance Is Not Reconciling Accounts Receivable To Ensure Federal Reports Are Accurate	17.225	0	See 02-CWD-13.
FY 01	01-CWD-11	The Division Of Unemployment Insurance Has Not Performed The 1999 Certification Of Employer Contributions	17.225	0	See 02-CWD-14.

(3) Corrective action taken is significantly different from corrective action previously reported:

There were no findings to report in this category.

(4) Audit finding no longer valid or does not warrant further action:

There were no findings to report in this category.

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2002

Fiscal Year	Finding Number	Finding	CFDA Number	Questioned Costs	Comments
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Material Weaknesses/Noncompliances

(1) Audit findings that have been fully corrected:

FY 01	01-CWD-4	The Division Of Unemployment Insurance Did Not Have A Reliable Trial Balance	NA	0	Resolved during FY 02.
FY 01	01-CWD-5	The Division of Unemployment Insurance Continues To Materially Misrepresent Its Corrective Action Plan To Provide A Trial Balance For Employer's Tax Collections	NA	0	Resolved during FY 02
FY 01	01-CWD-13	The Department For Training And ReEmployment Did Not Follow Up On Subrecipient Findings In A Timely Manner	17.255	0	Resolved during FY 02.
FY 01	01-CWD-14	The Department For Training And ReEmployment Has Not Fully Implemented Its Corrective Action Plan To Monitor Subrecipient Reports	17.255	0	Resolved during FY 02.
FY 00	00-CWD-3	The Division Of Unemployment Insurance Should Implement The Corrective Action Plan To Assure The Closing Package Schedule For Account Receivable Is Correct	NA	0	Resolved during FY 02.
FY 99	99-CWD-9	The Office Of Training And ReEmployment Should Comply With Job Training Partnership Act Regulations And OMB Circular A-133 Regarding Resolution Of Subrecipient Audit Findings	17.246 17.250	0	Resolved during FY 02.

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2002

Fiscal Year	Finding Number	Finding	CFDA Number	Questioned Costs	Comments
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Material Weaknesses/Noncompliances

(2) Audit findings not corrected or partially corrected:

FY 99	99-CWD-3	The Division of Unemployment Insurance Should Ensure Computer Accounting Systems Are Operating Effectively And Amounts Reported From Those Systems Can Be Supported	N/A	0	The trial balance was not used as supporting documentation for the current year therefore this portion of the comment is resolved; however, the portion related to system inadequacy remains, see 02-CWD-2.
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(3) Corrective action taken is significantly different from corrective action previously reported:

There were no findings to report in this category.

(4) Audit finding no longer valid:

There were no findings to report in this category.

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2002

Fiscal Year	Finding Number	Finding	CFDA Number	Questioned Costs	Comments
<u>Other Matters</u>					
<i>(1) Audit findings that have been fully corrected:</i>					
FY 96	96-WFDC-1	The Cabinet For Workforce Development Should Comply With JTPA Financial Management Guide And OMB Circular [A-128 For FY 96] By Properly Monitoring And Resolving Subrecipient Audit Findings	17.250	0	Resolved during FY 02.
FY 98	98-WFDC-4	The Cabinet For Workforce Development Should Ensure That All Write-Offs From Accounts Receivable Are Properly Authorized Prior To Processing	N/A	0	Resolved during FY '02.
FY 01	01-CWD-6	The Kentucky Department Of Revenue Is Not Depositing Unemployment Insurance Tax Receipts Timely	N/A	0	Resolved during FY '02.
FY 01	01-CWD-15	The Department For Training And ReEmployment Did Not Provide Supporting Documentation For Parts Of The Performance Report	17.255	0	Resolved during FY 02.
<i>(2) Audit findings not corrected or partially corrected:</i>					
FY 98	98-WFDC-9	The Cabinet For Workforce Development Should Properly Review Federal Reports And Supporting Documentation For Accuracy (ETA 581)	17.225	0	See 02-CWD-13.

(3) Corrective action taken is significantly different from corrective action previously reported:

There were no findings to report in this category.

(4) Audit finding no longer valid:

There were no findings to report in this category.

